REPORT

of the

LEGISLATIVE COUNCIL COMMITTEE

on

STUDYING THE FEASIBILITY OF INCENTIVES FOR CONSTRUCTION OF WASTE TREATMENT FACILITIES

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COMMITTEE STUDYING THE FEASIBILITY OF INCENTIVES FOR CONSTRUCTION OF WASTE TREATMENT FACILITIES

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REPORT OF THE COMMITTEE

TO STUDY THE FEASIBILITY OF INCENTIVES FOR CONSTRUCTION OF WASTE TREATMENT FACILITIES

1. Summary

This committee was asked to consider whether the State of Maryland should provide some form of tax or other incentive or assistance to private industries that construct waste treatment facilities. In the course of our deliberations, we held hearings in Baltimore, Frederick and Easton. We also obtained testimony from all the State government agencies concerned with these matters. We wish to express our appreciation to all those who took the time and effort to present their views to us. We particularly appreciate the efforts of the Baltimore Chamber of Commerce, who presented a detailed and thoughtful proposal to us.

The committee believes that a tax incentive for pollution abatement is not justified in Maryland. We believe that a statewide Waste Acceptance Service, now being considered by the state, offers the best hope for success in dealing with Maryland's pollution problems, and we recommend its speedy adoption. These recommendations are discussed further in section 5.

2. Introduction

For generations, Americans assumed that clean air and water were available in unlimited quantities. In recent decades we have gradually and painfully become aware that the assumption was false. As population and economic activity have grown, it has become clear that misuse of our precious air and water resources has done costly and irreparable damage to them. Fortunately, instances are rare in the United States in which poor quality air and water threaten human life itself. But deterioration in air and water resources has impaired the quality of our urban environment, reduced the efficiency of the economy, and in some cases has been injurious to health.

As a result of this deterioration, it has now become an accepted part of national, state and local policy to improve the quality of our air and water resources. Maryland, with its unique fresh and salt water resources, has wisely been among the leading states in efforts to abate water pollution. Air pollution has been a less urgent problem and has received less attention both nationally and locally, but improved air quality is now an accepted goal of public policy.

We believe that Maryland cannot afford to have polluted air and water. Increasingly, jobs and people are attracted to areas where generous supplies of clean water are available for industrial, municipal and recreational uses. Maryland's best advertisement is that we are determined that our air and water resources will be of high quality. But considerable expenditures of money will be necessary. State and local governments in Maryland already spend millions of dollars each year on water supply and waste treatment facilities. Industry also spends substantial amounts. And these expenditures will probably have to grow during coming years.

3. Alternatives

The following forms of incentive or assistance were considered by the committee:

(a) Exemption from state sales tax of materials and equipment for pollution control. This could reduce the initial cost of treatment facilities to industry by 2% at most, since that is the current sales tax on industrial equipment.

(b) Exemption from property tax of land and facilities for pollution control. This would mainly affect the receipts of local rather than state government, since state real estate taxes are small.

(c) A credit against the state corporate income tax for expenditures on land, plant and equipment for pollution control. Under this proposal, an industry would take a percentage of the cost of pollution control facilities, and deduct that amount from its state corporate income tax liability over a period of years. For example, the law might permit a firm to take 50% of the cost of a facility, and deduct 10% of that, or 5% of the total cost of the facility, from its tax liability in each of the 10 years following purchase of the facility.

(d) Rapid depreciation of pollution control facilities for state tax purposes. This would permit a firm to depreciate pollution control facilities for tax purposes over shorter periods than the estimated useful lives of the plant and equipment.

(e) Effluent fees. Proposal (e) is a different kind of incentive. Under it, a firm would pay a fee or tax that depended on the amount and quality of effluents discharged to the air or to bodies of water. Although this incentive has been used abroad, it has not been used in the United States to our knowledge.

(f) Direct subsidy to industries that install pollution control facilities. Under proposal (f), the State would reimburse firms for a part of their outlays on pollution control facilities. If desired, the subsidy could be given selectively. For example, it could be given only when hardship had been established by the firm.

(g) Direct loans or loan guarantees to industries that install pollution control facilities. Under proposal (g) the State could sell bonds to provide a fund from which loans could be made. Loans of state money to firms for pollution control facilities would presumably be constitutional since pollution abatement is a public purpose. It would be possible to charge borrowers an interest rate that would pay the carrying charges on the State debt and the costs of administering the loan program. Such a rate would still be lower than rates at which most firms can borrow. If desired, loans could be given selectively, for example to hardship cases. Loan guarantees could be given in much the same way.

4. Analysis of alternatives

These alternatives should be evaluated according to their efficiency and their equity. Efficiency requires that the policy chosen achieve the greatest pollution abatement possible per dollar of state funds expended or revenue foregone, that industry not be induced to spend its own funds for pollution control in inefficient ways, and that the proposal not interfere with other goals of public policy. Equity is a subjective notion and concerns who pays for pollution abatement, industry and its customers or the public through the state's tax powers.

a. Efficiency. There are several aspects of the efficiency criterion.

First, there is ample evidence that in many industries there are several ways of reducing the discharge of waste. The most obvious, in the case of water-borne wastes, is conventional treatment of organic wastes. But frequently the most economical way of abating waste discharge is to make process changes that reduce the amount of waste produced. Indeed, many process changes that reduce waste discharges are made in the normal course of plant modernization. There are many others that could be made to abate waste discharges, but are not sufficiently profitable to be in industry's interest. Now proposals (a) through (d), when they have been adopted by some states, have been employed mainly when industry has constructed conventional waste treatment facilities. But the result is that industry is often induced to adopt an unnecessarily expensive method of abatement, which is inefficient. If the attempt were made to apply these proposals to process changes, it would be a formidable administrative problem to decide what part of the expenditure was for modernization and what part for pollution control. Considerable litigation would seem likely. *In summary, proposals (a) through (d) would be inefficient or administratively burdensome, or both. Proposal (e) does not have this defect, and proposals (f) and (g) need not since they can be used selectively.*

A second aspect of the efficiency criterion has to do with the complex nature of corporate profit taxation in our federal system. Proposals (a) through (d) help industry by making some state or local tax liability less that it would otherwise have been if the industry installs pollution control facilities. But state and local taxes are deductible on federal corporate (and personal) income tax forms. Thus, every dollar of tax assistance provided to industry by state or local government is one dollar less of allowable deductions on the industry's federal tax form. To an industry in the top federal corporate tax bracket, the result is an increase in its federal tax liability by about 50 cents. *Thus, for every dollar of assistance provided at the state or local level, the firm receives only 50 cents. This is a second form of inefficiency in proposals (a) through (d).*

A third aspect of the efficiency criterion is that tax incentives for pollution control are not really incentives in the usual sense. Expenditures for pollution control (with some exceptions involving the recovery of saleable products) do not yield revenues or profit. Thus, tax assistance under proposals (a) through (d) merely reduces the losses on unprofitable expenditures. But they are still unprofitable. The real incentive for pollution control expenditures is the threat of an enforcement action if the expenditures are not undertaken. *Thus, proposals (a) through (d) again fail on the efficiency criterion.* The argument in this paragraph does not apply to proposal (e), or to (f) and (g) if they are used selectively.

The fourth aspect of the efficiency criterion is that no public policy to abate pollution can be regarded as efficient if it drives existing firms to other states or deters firms from locating here. *It is our considered judgment that the tax relief provided by proposals (a) through (d) is not needed to allow Maryland to remain competitive with other states.* The amounts of money involved in proposals (a), (b) and (d) are not large in relation to pollution control expenditures to which they would apply. Amounts involved in proposal (c) could be large, so large in fact that Maryland's revenue posture would be vitally affected. If tax revenues are reduced below what they would otherwise have been by granting relief for pollution control expenditures, it means taxes from some other sources must necessarily be higher. Such higher taxes may adversely affect the

state's competitive position in attracting industry. *However, we feel that proposal (e), although perhaps justifiable at the national level, would be inefficient for a state because a schedule of fees high enough to abate pollution might damage the state's competitive position.*

The final aspect of the efficiency criterion has to do with the provisions of the state corporate income tax law. The state has now adopted the federal base in its tax law, and proposal (c) would require a modification of that base. *This would be a move away from simplification and standardization in the state's tax laws.*

b. Equity. The principle of equity refers to a fair sharing of costs of pollution abatement between public and private funds. There are two divergent views. One is that pollution abatement should be viewed as a normal cost of doing business, just as is the cost of meeting health and safety regulations in industry, and should be paid for by industry (in which case it will presumably be passed on to industry's customers to the extent market conditions will permit). The other view is that pollution abatement benefits the public and the public should therefore pay the cost through taxation. To some extent, the issue is a matter of opinion and complete reconciliation between opposing views is probably not possible. But we believe it is desirable to strike a balance between these views.

Clearly, if public policy imposed no costs of pollution on industry, firms would discharge so much pollutant that urban life would be unbearable. But clearly the public does benefit from clean air and water, and if the public demanded that firms pay to abate pollution completely, the cost would be prohibitive. *We believe that pollution abatement is and should be a joint public-private responsibility in the United States.*

It is easy to establish that a great deal of expenditure on pollution abatement already comes from public funds.

First, if a firm spends $100,000 on pollution abatement, it is normally a deductible cost on both federal and state corporate income taxes. In addition, these expenditures are eligible for the federal investment tax credit, and for accelerated depreciation. Thus, the $100,000 expenditure would reduce the firm's after-tax profits by less than $43,000. Therefore, considerably more than half of all corporate anti-pollution expenditures are now financed through public funds by the reduction of the corporation's tax liability.

Second, all levels of government make large direct expenditures for pollution abatement. The federal government spends about $300 million a year for research and development, training and grants for water pollution control. Perhaps $1 billion per year is spent on water pollution control by state and local governments. (Industry spends about $600 million per year.) Maryland probably accounts for a disproportionately large share of this expenditure, although data are unavailable. (Similar figures are not available for air pollution abatement.) Thus, the three levels of government already finance about two-thirds of all expenditures on water pollution abatement in the United States. In Maryland, there has recently emerged an additional large government expenditure for water pollution control. Because of its budget cuts, the federal government has not been able to pay its share (50-55%) of matching grants for construction of approved waste treatment facilities by municipalities. The state, in addition to its own matching grant of 25%, has advanced funds to municipalities against the future receipt of approved federal grants. Such state advances will amount to millions of dollars this fiscal year. Of course,

the state will be reimbursed when and if the federal grants come through, but the magnitudes suggest it will take several years at best.

We do not believe there is a strong argument on equity grounds for a further increase in the state's share of expenditures for pollution control.

5. Recommendations

On the basis of the analysis in Section 4, we believe that a tax incentive for pollution abatement is not desirable in Maryland.

We recognize, however, that industrial expenditures for pollution abatement will be substantial during coming years. Those industries discharging to a municipal collection and treatment system enjoy substantial benefits. The State regulatory agencies encourage municipalities to accept industrial waste wherever it is feasible. When industrial wastes are included in the municipal system, both domestic and industrial dischargers benefit from the economies of scale and the generous State and Federal grants which amount to a maximum of 80 per cent for treatment facilities and 50 percent in some cases for collection works.

In response to Senate Joint Resolution 48, adopted by the General Assembly of Maryland during the 1966 Session, a study Commission was formed to investigate the problems of water pollution control. That Commission recommended the establishment of a Statewide sanitary district to be known as the Waste Acceptance Service. That Service would accept and treat all municipal and industrial wastes generated within the State of Maryland. Its service would be mandatory and provided on a wholesale basis, leaving the decisions of industrial management and local government in the hands of appropriate local officials.

The Commission's recommendation was made early in 1967 and since then, under authority provided by the Board of Public Works, the Waste Acceptance Service has been the subject of a thorough feasibility study by Trident Engineering Associates of Annapolis. The engineering consultants concluded that the proposal was sound and held forth more promise for efficient and effective water pollution control in the State of Maryland than any alternative. The consultants are now studying financial and other important considerations in detail and are preparing a legislative proposal which would authorize the creation of the Waste Acceptance Service.

This Committee concurs in the principle of a Statewide sanitary district and believes that such a service could provide industry with true incentives for abating water pollution. We recommend that the Study Commission to Investigate the Problems of Water Pollution Control proceed as rapidly as possible to formulate proposed legislation authorizing the establishment of the Waste Acceptance Service and that proposed legislation be submitted promptly to the Governor and the General Assembly in keeping with the charges contained in Senate Joint Resolution 48.

With respect to air pollution control on the part of industry, the Committee recognizes that industry is faced with a new set of mandatory cost factors. Some regulations have been adopted and others are under consideration which will substantially change the cost of doing business within the State of Maryland. In a harsh but true sense, the law and regulations are the only incentives required to cause industries to abate air pollution. A provision in the law which allows a business firm to submit a plan for coming into compliance with regulations, permits phasing

and budgeting of necessary alterations and improvements so that some of the sudden financial impact can be relieved. As a matter of equity, it is possible that the State may find it desirable to assume a share of the cost of controlling industrial air pollution. However, at this early stage of the program, the experience and judgment required to evaluate the advisability of State assistance have not been gained.

The Committee does not believe that useful purposes would be achieved by industry or government through the various tax incentive proposals suggested to us during our hearings and deliberations.